No. 14112

In the United States Court of Appeals for the Ninth Circuit

Lois J. Newman (formerly Lois J. Senderman),
PETITIONER

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The opinion of the Tax Court (R. 93-111) is reported at 19 T. C. 708.

JURISDICTION

The petition for review (R. 112-114) involves a deficiency in gift tax for the taxable year 1946, in the amount of $50,079.84. Notice of deficiency was mailed to the taxpayer on May 3, 1950. (R. 11-14.) The taxpayer filed an amended petition for determination with the Tax Court on November 2, 1951 (R. 17-23), under the provisions of Section 1012 of the Internal Revenue Code. The decision of the Tax Court was entered on

May 15, 1953. (R. 111-112.) The case was brought to this Court by a petition for review filed by the taxpayer on August 10, 1953. (R. 112-114.) Jurisdiction is conferred on this Court by Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the Tax Court correctly held that a transfer of property to a trustee in 1943 did not constitute a completed gift, since the trust was a revocable one under state law, but that the gift was completed in 1946 upon the termination of the trust and distribution of the corpus to the guardian for the beneficiary.[1]

STATUTES AND REGULATIONS INVOLVED

These are set forth in the appendix, *infra*.

STATEMENT

A portion of the facts was stipulated by the parties (R. 26-34), and, by reference, were made part of the Tax Court's findings of fact (R. 94). The additional findings of the Tax Court, pertinent to the issue here involved, are as follows:

The taxpayer resides in California. She was divorced from Aaron Senderman in 1940. Prior to December,

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[1] Another issue decided below is not involved here. The Tax Court held that it was error for the Commissioner to include within the gift consummated May 2, 1946, the amount of $64,035.05, representing an alleged overpayment by the beneficiary and the trust of income tax and accrued interest for 1943 to 1945, inclusive, since the question whether the corpus and the earnings therefrom constituted the taxpayer's property is now pending before the Tax Court in another proceeding. (R. 109-111.) A petition for review of the Tax Court's decision on this issue, filed by the Commissioner for protective purposes, was dismissed by order of this Court on November 18, 1954, upon stipulation of the parties.

1944, and at all times here material, her name was Lois J. Senderman. In December, 1944, she married Louis Newman, and her name from that time to the present has been Lois J. Newman. She has had only one child, Lois E. Senderman, born in 1935. (R. 94-95.)

For a number of years prior to January 1, 1943, the taxpayer owned as her separate property 2,396 7/8 shares of stock of the Aztec Brewing Company, hereinafter called Aztec. On or about January 1, 1943, the taxpayer transferred to Richard S. Goldman, her attorney, 800 shares of the Aztec stock in trust for her daughter. Upon receipt of the stock, Goldman orally declared himself to be trustee, effectively immediately. Six or seven months later, Goldman executed a written declaration of trust which was predated to January 1, 1943, and was not "expressly made irrevocable." (R. 95.)

The taxpayer filed federal and State of California gift tax returns for 1943 in which she reported a gift in trust of the 800 shares of Aztec stock at a value of $30,000, with no gift tax payable thereon. (R. 95-96.)

On or about February 24, 1944, Aztec Brewing Company, a limited partnership was formed. On or about March 31, 1944, the Aztec corporation was dissolved and its assets and liabilities were transferred to the partnership. The stockholders in the corporation became partners in the new partnership, with interests proportionate to their respective stockholdings. The trust for Lois E. Senderman became a limited partner with an eight percent interest, the fair market value of which on May 2, 1946, and throughout the calendar year 1946, was $151,051.09. (R. 96.)

On March 1, 1946, Richard S. Goldman died, and on March 26, 1946, Richard N. Goldman, his son, was appointed and qualified as the executor of his estate. On April 5, 1946, Clarissa Shortall, who had been associated with the elder Goldman and had participated with him in the handling of the trust matters in question, was appointed successor trustee to Richard S. Goldman by order of the Superior Court in and for the City and County of San Francisco, California. The written trust provided for the appointment of a guardian and the creation of a guardianship estate upon the resignation or death of the original trustee. On May 2, 1946, Clarissa Shortall was appointed guardian of the estate of Lois E. Senderman and the assets of the trust were transferred to her. (R. 96-97.)

On April 22, 1947, after a revenue agent had examined the tax returns of the taxpayer and her daughter, and had raised a question as to the revocability of the trust, Clarissa Shortall, as guardian for the minor, filed a petition with the Superior Court for instructions, paragraph 6, which reads in part, as follows (R. 97):

> 6. That it was the intention of said Lois J. Newman, said trustor and donor, and of Richard S. Goldman, said Trustee, that said trust, * * * be irrevocable and that the gift made thereby be irrevocable; and that the failure so to state specifically in said Declaration of Trust occurred through inadvertence and error and contrary to the express instructions of said Lois J. Newman.

On June 23, 1947, she filed an amended petition for instructions in which, for the first time, reference was

made to the existence of an oral trust. This petition stated that through inadvertence and error the written trust had failed to contain an express provision as to its irrevocability. (R. 97-98.)

On June 24, 1947, the taxpayer filed a gift tax return for 1946 as a protective measure. The return stated that no gift had been made in 1946, and it showed no tax owing for that year. (R. 98.)

On July 10, 1947, a hearing was held on the amended petition for instructions. Oral and documentary evidence was offered. Clarissa Shortall, as guardian, and the taxpayer appeared in person and by their respective attorneys. The court decreed that (R. 98-99):

> 1. On or within a few days after January 1, 1943, said Lois J. Senderman (now Lois J. Newman) orally created an irrevocable trust by instructing Richard S. Goldman to act as trustee of 800 shares of stock of Aztec Brewing Company, the certificates of which he held in his possession and by said Richard S. Goldman orally agreeing to do so. Said oral trust became effective immediately upon its creation and continued in effect until terminated by the appointment of Clarissa Shortall as guardian of the estate of said minor on May 2, 1946, and the transfer on or about said date of said trust property to said guardian.
>
> 2. Some six or seven months after the creation of said oral trust said Richard S. Goldman executed a written trust. * * * Said written trust was intended to embody the terms of said oral trust.
>
> 3. Said written trust did not terminate or modify said oral trust theretofore created but said

oral trust continued in effect until terminated on May 2, 1946, by the appointment of Clarissa Shortall as guardian of the estate of said Lois E. Senderman and the transfer of the trust property to her as said guardian.

4. Said Clarissa Shortall as such guardian has held and now holds said property irrevocably for the use and benefit of said minor.

With respect to the written trust, the Tax Court held that it was not expressly made irrevocable by the instrument creating it and was therefore revocable under California law. With respect to the oral trust, the Tax Court held that it, too, was revocable. This conclusion rested not only upon substantial evidence that the oral trust was not intended to be irrevocable but also upon the fact that it was replaced by the written trust. As to both trusts, the Tax Court held that the state court decree of July 24, 1947, was not binding for federal tax purposes because, in the circumstances of the case, it did not represent an independent judgment in a real controversy between the parties. Having found that neither of the trusts created in 1943 was, under state law, irrevocable, and that, accordingly, no completed gift was consummated in that year, the Tax Court held that the May 2, 1946, transfer of trust assets to the guardianship estate of the taxpayer's daughter constituted a completed gift, with consequent gift tax liability in that year. In connection with this transfer, the Tax Court held that the state court which ordered it did not act as an arbiter between two contesting parties but that its function was merely to see that the transfer was in accord with the trust instru-

ment and that it exercised discretion only with respect to the appointment of a fit guardian. (R.104-109.)

SUMMARY OF ARGUMENT

The taxpayer made no completed gift of the Aztec stock in 1943. The written trust executed in that year was patently revocable, since, as required by California law, it was not expressly made irrevocable. The oral trust (whether or not California law at that time permitted the creation of an irrevocable oral trust) was intended to be revocable, as the Tax Court found. Furthermore, it was replaced by the written trust instrument. The 1947 decree of the state court did not retroactively fix the quality of irrevocability upon both the oral and written trusts for federal tax purposes, since, in the circumstances of this case, the proceedings did not involve a real controversy between the parties. A completed gift of the Aztec stock was effectuated in 1946 when, upon the death of the trustee and pursuant to the provisions of the written trust instrument, the stock was unconditionally transferred to the guardian for the taxpayer's daughter. Although the transfer was sanctioned by court order, imposition of the gift tax was not thereby foreclosed under the doctrine of *Harris* v. *Commissioner,* 340 U.S. 106, since the operative factor in the transfer was the written trust agreement itself and the role of the court was a limited one.

ARGUMENT

The Tax Court Correctly Held That Completed Gifts Were Not Effectuated in 1943 by Either the Oral or Written Trusts, Both of Which Were Revocable, But That a Transfer Evoking Gift Tax Liability Was Made for the First Time in 1946 When the Written Trust Was Terminated and the Corpus Was Distributed to the Guardian for the Beneficiary

A. *The controlling written instrument created a revocable trust.*

The issue in this case is a narrow one. Did the taxpayer transfer property subject to the gift tax provisions in 1943, when, as she contends, she had irrevocably transferred certain shares of stock in trust for the benefit of her minor daughter—or, as the Commissioner and the Tax Court determined, and as we contend, was a completed gift first effectuated in 1946 (and a gift tax owing as of that year) when the revocable written trust was terminated and distribution of its corpus was made to a guardian for the minor?

The basic facts, as found by the Tax Court, may be briefly summarized as follows: On January 1, 1943, the taxpayer orally transferred to her attorney certain shares of stock of the Aztec corporation to be held by him in trust for her minor daughter. Six or seven months later a written declaration of trust was executed. It was pre-dated to January 1, 1943. It was not expressly made irrevocable and it made no reference at all to the existence of any oral trust. The taxpayer filed a federal gift tax return for 1943, reporting the value of the alleged gift of stock to the trust as $30,000, with no gift tax owing thereon. In 1944, the Aztec corporation was dissolved. Its assets were transferred to a partnership in which the trust became a

limited partner with an eight percent interest, the value of which throughout the calendar year 1946 was $151,051.09. On March 1, 1946, the trustee died. On April 5, 1946, Clarissa Shortall, an attorney who had been his associate and who had participated in the handling of the trust matters, was appointed as successor trustee. The oral trust was not mentioned in the petition filed for the appointment of the successor trustee. The provisions of the written trust required that upon the resignation or death of the original trustee the trust was to terminate and a guardianship estate was to be created. Pursuant thereto, on May 2, 1946, Clarissa Shortall was named guardian and the assets of the trust were transferred to her. No mention of any oral trust was made in the petition for appointment of guardian or in the order appointing the guardian. On April 22, 1947, after a revenue agent who had examined the tax returns of the taxpayer and of her daughter had raised some question concerning the revocability of the trust, the guardian filed a petition for instructions in the Superior Court in which she alleged that the taxpayer and the original trustee had intended the trust to be irrevocable and that (R. 76), "through inadvertence and error and contrary to the express instructions" of the taxpayer, the declaration of trust had failed to state that it was irrevocable. This petition made no reference to any oral trust. On June 23, 1947, the guardian filed an amended petition for instructions, in which, for the first time, reference was made to an oral trust. A hearing on the amended petition was held on July 10, 1947. Appearances were entered by the guardian and the taxpayer and their respective attorneys but, as the Tax Court observed,

the proceeding involved no real controversy between the parties. The Superior Court decreed (1) that the oral trust entered into on or about January 1, 1943, was an irrevocable trust which became effective immediately upon its creation and which continued until May 2, 1946, when the guardian was appointed and the assets of trust were transferred to her; (2) that the declaration of trust executed thereafter was intended to embody the terms of the oral trust; and (3) that the written trust did not terminate or modify the oral trust.

Upon these facts, we submit that the Tax Court correctly concluded that the written declaration of trust, and not the oral trust, is controlling here, that, under California law, the written instrument clearly created a revocable trust; that, after its termination, it was not made retroactively irrevocable for federal tax purposes by state court proceedings which did not constitute a real and bona fide controversy between the parties; and that there was therefore no valid transfer of title for gift tax purposes until 1946, upon termination of the revocable trust and unconditional transfer of the trust property to the guardian for the minor.

The written trust instrument was executed in 1943. Under the applicable California law (Deering, Civil Code of California (1937), Section 2280 (Appendix, *infra*)), every voluntary trust which was not expressly made irrevocable by the instrument creating it was revocable. The instrument here was a voluntary trust, since it constituted an obligation arising out of a personal confidence reposed in and voluntarily accepted by the trustee for the benefit of the taxpayer's daughter. Deering, Civil Code of California (1937), Section 2216

(Appendix, *infra*). It was not an involuntary trust, since it was not created by operation of law. Deering, Civil Code of California (1937), Section 2217 (Appendix, *infra*). As the Tax Court found, and as appears obvious from a reading of the instrument (R. 38-41), it was not expressly made irrevocable.[2] Whether, as the taxpayer claims, this was through oversight, or whether, as the Tax Court in effect found upon full consideration of the evidence, it was deliberate, is immaterial. It was under California law, a revocable trust (*Gaylord* v. *Commissioner,* 153 F. 2d 408 (C.A. 9th); *Krag* v. *Commissioner*, 8 T.C. 1091), and if the taxpayer had elected to exercise her right to revoke it, the trustee would have been under an obligation to

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[2] The taxpayer has tenuously attempted (Br. 23-24, 31-37) to glean from the language of the written instrument some intimation that 800 shares of Aztec stock were therein treated as a completed gift. A similar argument was unsuccessfully made in *Krag* v. *Commissioner,* 8 T. C. 1091, 1095-1096. There, the taxpayers contended that the trust agreements were not mere declarations of trust but contained language in effect evidencing gifts *inter vivos.* But the court held that the retention of legal title by a donor or third person to hold for the purposes of trust pointed to gifts in trust. The same conclusion is required in the instant case. As stated in *Colton* v. *Colton,* 127 U. S. 300, 310: "If it appear to be the intention of the parties from the whole instrument creating it that the property conveyed is to be held or dealt with for the benefit of another, a court of equity will affix to it the character of a trust, * * *." The written trust (Ex. 2-B, R. 38-41) makes it clear that Richard S. Goldman was holding "certificates of stock as trustee", that Lois E. Senderman was one of the "beneficial owners", and that he was holding 800 shares of Aztec stock for her upon terms and conditions consistent only with the declaration of a gift in trust. It may also be observed that while, on the one hand, the taxpayer appears to rely upon the written instrument as a mere acknowledgment "that the oral completed gift had already been made"—and not as a trust—(Br. 27), she nevertheless appears to imply, although guardedly (Br. 35), that the written instrument was a trust and that appropriate words of irrevocability were used. albeit short of the "magic word"—"irrevocable."

transfer to her the "full title to the trust estate." Section 2280, California Code. In failing to create an expressly irrevocable trust, the taxpayer in substance had reserved the power to revest the beneficial title to the property in herself. Clearly, therefore, the transfer under the written trust instrument did not effectuate a completed gift. A gift is complete where "the donor has so parted with dominion and control as to leave in him no power to change the disposition thereof, whether for his own benefit or for the benefit of another" but "is incomplete in every instance where the donor reserves the power to revest the beneficial title to the property * * *." Treasury Regulations 108, Section 86.3 (Appendix *infra*). The gift tax statute is "aimed at transfers of the title that have the quality of a gift, and a gift is not consummate until put beyond recall." *Burnet* v. *Guggenheim,* 288 U.S. 280, 286.

In an attempt to overcome the patent defect in the written trust, i.e., that it was not expressly made irrevocable, the taxpayer contended in the Tax Court that (1) the written trust was in fact irrevocable because it was intended to embody the terms of the prior and alleged irrevocable oral trust and (2) in any event, the Superior Court's order of July 24, 1947, was a conclusive determination *nunc pro tunc* that the written trust (as well as the oral trust) was irrevocable.[3]

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[3] The Tax Court restated the taxpayer's position below as follows (R. 103):

> Petitioner * * * maintains that not only does the *trust instrument* in controversy meet the requirements of section 2280 * * * as respects its irrevocability but also that the oral trust earlier created was intended to be, and was, irrevocable, and that *both trusts* remained in existence from the time they were created until they were both terminated in 1946. To support

Neither of the contentions has merit. As to the first, it may be observed preliminarily that there was no ambiguity in the written trust instrument and that therefore, as this Court stated under analogous circumstances in *Gaylord* v. *Commissioner, supra,* p. 415, its plain terms will control. Contrary to the taxpayer's contention (Br. 31-37), nothing in the language of the trust instrument even remotely suggests that it was the taxpayer's intention that the trust be irrevocable. The instrument is silent in this respect. Acts of the taxpayer, such as the filing of gift tax returns reflecting a completed gift in 1943 cannot, as the taxpayer contends (Br. 37), have the effect of amending the trust declaration. In reply to a similar argument in the *Gaylord* case, *supra,* this Court stated (p. 415):

> These returns were simply a report to the Government required by law and did not purport to change the nature of the trust. Any effective changes had to be made in the instrument itself.

Furthermore, even if it is assumed, *arguendo,* that the written trust was intended to embody the terms of the

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this position, petitioner points to the July 10, 1947 decree [filed July 24, 1947] of the Superior Court * * * so construing the *trusts*. (Italics supplied.)

The italics in the above excerpt point up a seeming shift in argument here. Point IV of the taxpayer's brief (pp. 27-37), appears now to assume that the written instrument was not a declaration of trust at all but rather a mere acknowledgment "that the oral completed gift had already been made." (P. 27). The apparent purpose of this shift is to emphasize the taxpayer's now virtually complete reliance upon the oral trust. This position appears to be echoed in Point V of the taxpayer's brief. (Pp. 31-37.) The intent of the argument there, however, is somewhat obscured by the concomitant effort to reconcile the "instrument", as the taxpayer consistently refers to it, with the provisions of Section 2280 of the California Code.

oral trust, the Tax Court nevertheless concluded, upon full consideration of the evidence, that the oral trust was intended to be revocable. The substantial basis for this conclusion is discussed below, in subdivision B.

With respect to the Superior Court's order of July 24, 1947, purporting to fix the quality of irrevocability to the written (and also to the oral) trust, the Tax Court properly held that it was not controlling for federal tax purposes since the proceedings before the state court did not constitute a real and bona fide controversy between the parties and the judgment of the court was in effect a consent decree. The facts support this conclusion. The petition for instructions filed by Clarissa Shortall, after the trust had terminated, alleged that some controversy had arisen between herself, as guardian, and the taxpayer relative to its irrevocability of a written trust. The guardian requested the court to find that the written trust was irrevocable. (R. 76-77.) At the hearing, the taxpayer testified and also urged the court to declare the written trust irrevocable. (R. 173.) Obviously, therefore, both parties were requesting the same finding. At the hearing in the Tax Court, the guardian stated that she had petitioned the Superior Court in 1947 because she feared that the trustor might try to have the trust revoked. (R. 172.) But she knew that by its very terms, whether revocable or irrevocable, the trust had terminated in 1946; and she further knew that she had received possession of the corpus in that year as guardian and that legal title had passed to the beneficiary. It is apparent, therefore, that the state court proceeding did not involve a real contest; rather, it represented a concerted action to obtain what in effect was a consent decree which

would adversely affect the Government's right to a gift tax. In these circumstances—which factually distinguish the instant case from those relied upon by the taxpayer (Br. 15-19)[4]—the tax court was not bound, as the taxpayer contends (Br. 13), to follow the state court order, as allegedly required by *Freuler* v. *Helvering,* 291 U.S. 35. There, the Supreme Court did recognize and give effect to a decision of a state court determining property rights. But, as stated in *Doll* v. *Commissioner,* 2 T.C. 276, 284, affirmed, 149 F. 2d 239 (C.A. 8th), certiorari denied, 326 U.S. 725:

> The Supreme Court indicated, however, that the decision must have been entered in a proceeding where there was a real controversy to be determined and after such trial as would properly and fully present the facts and issues. On the other hand, the inference is clear that it would not recognize and give effect to the decision of a state court in a proceeding which was "collusive in the sense that all the parties joined in a submission of the issues and sought a decision which would adversely affect the Government's right to additional income tax."

In *Saulsbury* v. *United States,* 199 F. 2d 578, 580 (C.A. 5th), certiorari denied, 345 U.S. 933, in dealing with a similar problem the court stated—

> it does not affirmatively appear that said order was obtained in an adversary proceeding and that

[4] The taxpayer's extended discussion (Br. 15-18) of *Goodwin's Estate* v. *Commissioner,* 201 F. 2d 576 (C.A. 6th), is inapplicable here since, to a substantial degree, that case turns on the application of a specific regulation to a specific subject, namely, the effect of a local court decree upon the amount of a claim against or the administration expenses of an estate.

there was no collusion. By the word *collusion,* we do not mean to imply fraudulent or improper conduct, but simply that all interested parties agreed to the order and that it was apparently to their advantage from a tax standpoint to do so. We mean that there was no genuine issue of law or fact * * * and no *bona fide* controversy * * * as to the property rights under the trust instrument.

In *Krag* v. *Commissioner, supra,* which the Tax Court characterized (R. 104) as strikingly similar to the instant case, the taxpayers executed trusts for the benefit of minor children which, as here, contained no express provision as to irrevocability. Subsequently, the Superior Court in and for the County of Marin, California, issued an order reforming the trusts and declaring them irrevocable *ab initio.* The Tax Court held that the trusts were revocable, under the provisions of Section 2280 of the California Code and, further, that the subsequent state court decree, purporting to establish irrevocability, was ineffectual for federal tax purposes. In language pertinent here, the court stated (pp. 1097-1098):

> It is true that the decree in the reformation suit ordered that each trust agreement "be reformed as of its original date to express the true intention of all of the parties thereto." It is also true, as contended by petitioners, that the cited cases hold that decisions of state courts determining property rights are binding upon Federal courts. However, such rule applies only to a decision entered in a proceeding presenting a real controversy for de-

termination. The decision must be on issues "regularly submitted and not in any sense a consent decree." *Freuler* v. *Helvering,* 291 U. S. 35, see also *Francis Doll,* 2 T. C. 276; affd., 149 Fed. (2d) 239; certiorari denied, 326 U. S. 725; *Tatem Wofford,* 5 T. C. 1152, 1161-1163; *Leslie H. Green,* 7 T. C. 263, 274. In the suit herein involved there was no real controversy. The purpose of the suit was to reform and amend the trust agreements so as to bring them without the purview of section 2280, i.e., to make them irrevocable. All the parties to the suit were in agreement in that respect. The petitioners, in so far as the records disclose, may have initiated the reformation suit, and probably did, since the beneficiaries were minors and there is no evidence of any controversy. The cases cited by petitioners are distinguishable and hence not applicable. They involved decisions of state courts of competent jurisdiction rendered in adversary proceedings after a hearing upon the merits, all of which decisions were in no sense consent decrees or "collusive in the sense that all the parties joined in a submission of the issues and sought a decision which would adversely affect the Government's right to additional income tax." *Freuler* v. *Helvering, supra.* In *Sinopoulo* v. *Jones* (C. C. A., 19th Cir.), 154 Fed. (2d) 648, the taxpayer executed declarations of trust for the benefit of his two daughters. Thereafter, effective as of August 1, 1941, Oklahoma passed a statute providing that every trust created under the laws of Oklahoma "should be revocable by the trustor unless expressly made irrevocable by the instrument creating the same." Because of the stat-

ute and of a doubt as to the construction that might be attempted to be placed upon the declarations of trust, taxpayer's daughter Mary, who had married against his will, brought suit for herself and as the next friend of her minor sister against taxpayer, asking for a construction as to the revocability of the trusts and for a reformation thereof. The court reformed the trust instruments by striking out a certain paragraph therein and inserting in lieu thereof another paragraph reading in part, as follows: "The trusts hereby created shall be and are irrevocable." The judgment of the court made the reformation retroactive and effective as of December 14, 1939, the date of the execution of the written declarations of trust. As to the effect of such judgment, the Circuit Court stated:

> The liability of appellant for the income tax chargeable to the income of the trusts for the years in question [1939, 1940, and 1941] must be determined from the provisions of the trusts prior to their reformation by the state court. While the judgment of the state court made the reformation of the trusts retroactive and effective as of the date of the execution, this could not affect the rights of the government under its tax laws.

The court held that the tax liability of Sinopoulo for the three years in question was to be determined from the provisions which he included in the declarations of trust which he executed, and not from what he intended to include therein.

The *per curiam* opinion of this Court in *Estate of Rainger* v. *Commissioner,* 183 F. 2d 587, affirming 12 T. C.

483, certiorari denied, 341 U. S. 904, is in accord, in principle. In that case, one of the questions was whether a California court's decision in an inheritance tax proceeding, that the decedent owned no community property, was a decision on the merits. Upon analysis of the proceeding (12 T. C. 483, 495-496), it was concluded, as in the instant case, that there was no real controversy between the parties on that issue and that the purported adjudication of property rights by the state court was therefore not binding upon the federal court.

It is submitted that the Tax Court properly held that the Superior Court's decree in the instant case was not retroactively effective for federal tax purposes. In the circumstances of the case, a contrary ruling would not only have disregarded the absence of a real controversy between the parties to the state court proceeding, but, in effect, would have permitted a retroactive judgment of a state court, contrary to the well established rule, to determine the rights of the Federal Government under its tax laws. .Cf. *Daine* v. *Commissioner,* 168 F. 2d 449, 451-452 (C. A. 2d) ; *Doll* v. *Commissioner, supra; Van Vlaanderen* v. *Commissioner,* 175 F. 2d 389 (C. A. 3d).

B. *There was no completed gift in 1943 under the oral trust.*

The oral trust was created on or about January 1, 1943. Even if it is assumed (1) that an oral irrevocable trust could have been created under California law in 1943,[5] and (2) that the oral trust here involved

[5] The applicable California law, as we have already observed, provided that *every* voluntary trust was revocable "Unless expressly made irrevocable by the instrument creating the trust * * *." Section 2280, California Code. The oral trust in this case was a volun-

was irrevocable, the taxpayer nevertheless cannot prevail. The undisputed fact is that the written trust was pre-dated to January 1, 1943, the date of the creation of the oral trust. Unless the written trust was intended to replace the oral trust, the pre-dating is meaningless. Since it would indeed be anomalous to assume the co-existence of two trusts, one oral and one written, involving the same corpus, the Tax Court correctly concluded (R. 106) that the substitution of the written instrument for the oral declaration rendered the oral trust "wholly void" and "effectively wiped out."

But the Tax Court's rejection of the oral trust as a controlling factor here was based primarily upon its conclusion that it was not intended to be irrevocable. The Tax Court held that the taxpayer's contrary position in this respect was not entitled to credibility because of "The inconsistencies in the evidence, the presence of contradicting documents, and the inferences to be drawn from the whole record * * *." (R. 106.) In this connection it was, of course, the Tax Court's function, as it properly observed (R. 106)—

> to weigh the evidence carefully, determine the probabilities of accuracy, and accept or discount the evidence by consideration of the interests of

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tary one, and, by definition, an oral trust is not created by any instrument. The creation of an oral irrevocable trust in 1943, would therefore appear to be questionable. Contrast this with the situation which existed under the California law (Ragland, Civil Code of California, Annotated (1929), Section 2280) prior to its amendment in 1931, when no trust could be revoked after its acceptance by the trustee and beneficiaries, except by the consent of all the beneficiaries, unless the declaration of trust reserved a power of revocation to the trustor. *Title Ins. & Trust Co.* v. *McGraw*, 72 Cal. App. 2d 390, 399, 164 P. 2d 846.

the parties, and thus, from the whole record, determine where lies the truth.

If its conclusion "that no irrevocable oral * * * trust existed" (R. 106) is supported by the record, it should not be disturbed, since as this Court has stated in *Gaylord* v. *Commissioner,* 153 F. 2d 408, 415: "Weighing the evidence, determining its probative value and drawing inferences therefrom is peculiarly and exclusively the function of the Tax Court." That the record did raise substantial doubt as to the existence of an irrevocable oral trust is clear. The oral trust was created on or about January 1, 1943. Six or seven months later, the written declaration was executed and it was pre-dated to January 1, 1943. Yet, the written instrument made no mention of any oral trust, either revocable or irrevocable. The Tax Court considered this omission significant, stating (R. 105):

> The existence of the oral trust was not mentioned in the written instrument, albeit petitioner now contends it was in full force and effect for six or seven months. When the written trust was being prepared, two lawyers, one of them the trustee under the trust, the other his associate and successor as advisor to the trust, both experienced and fully cognizant of the desires of the donor, participated in the drafting of the instrument. Despite the fact, if it be a fact, that both lawyers understood that petitioner wished an irrevocable trust, no reference was made to an existing irrevocable oral trust nor was the word "irrevocable," or any word to the same effect, used or incorporated specifically, or by interpretation or by proper inference, in the writing.

The Tax Court further stated (R. 107):

> If the oral trust was intended to be irrevocable, why, when it was transmuted into the written trust, did the written trust fail to mention either the oral trust or the word "irrevocable"? We find it impossible to believe that Goldman, an experienced lawyer, presumptively familiar with the provisions of Section 2280 of the California Code and cognizant of all the facts, would inadvertently omit from the declaration of the trust the express provision called for by the statute. One sentence of five words would have sufficed to have removed all question as to the revocability of the trust. * * *

In addition, the Tax Court found it (R. 105) "difficult to comprehend * * * that the oral trust on which the petitioner now so heavily leans was not mentioned" (1) in the petition filed by Clarissa Shortall on April 5, 1946, for the appointment of a successor trustee or (2) in the petition thereafter filed for her appointment as guardian of the estate of the taxpayer's daughter; or (3) in the order of May 2, 1946, appointing her as guardian; or (4) in the original petition filed by her on April 22, 1947, for instructions concerning the nature of the trust, *despite the fact that prior thereto a revenue agent had examined the tax returns of the taxpayer and her daughter and had raised a question as to the revocability of the trust* (R. 97). The original petition referred only to the written instrument and stated in part (R. 76):

> 6. That it was the intention of said Lois J. Newman, said trustor and donor, and of Richard S.

> Goldman, said Trustee, that said trust, * * * be irrevocable and that the gift made thereby be irrevocable; and that the failure so to state specifically in said *Declaration* of Trust occurred through inadvertence and error and contrary to the express instructions of said Lois J. Newman. (Italics supplied.)

The first reference to an oral trust was made on June 23, 1947, when the guardian filed an amended petition for instructions. The timing would appear to be significant. As already noted, the original petition for instructions was filed on April 22, 1947, and it referred only to the written declaration of trust, a copy of which was attached. (R. 74.) This petition requested (R. 77) "a decree * * * declaring that said trust and the gift made thereby were irrevocable * * *." The taxpayer appeared to be following the method employed in the *Krag* case, *supra,* namely, an attempted *ab initio* reformation of a written trust instrument by court decree in order to establish its irrevocability. The decision in the *Krag* case, which made it clear that that method would not succeed, was handed down on May 16, 1947. The amended petition for instructions here was filed on June 23, 1947. (R. 29-30, 97).) Significantly, it referred to the *oral* and written trusts and prayed *inter alia* (R. 82)—

> for a decree * * * declaring that said Lois J. Senderman *orally* created an irrevocable trust * * *; that said oral trust * * * terminated by the appointment of * * * [the] guardian and the transfer of the trust property to * * * [the] guardian; * * *." (Italics supplied.)

The circumstances would suggest that the hypothesis of an irrevocable oral trust which purportedly continued in existence from January 1, 1943, to May 2, 1946, was relied upon in order to overcome the obstacle of the *Krag* decision. However, as we have already observed, the Tax Court was not required to predicate its rejection of the taxpayer's position upon any inference flowing from the chronological and factual relationship between the *Krag* decision and this case, for, upon a consideration of the "whole record ~~record,~~" including the testimony of the taxpayer and her lawyer, the Tax Court found as an ultimate fact that "no irrevocable oral * * * trust existed." (R. 106.) This finding, in the light of the evidence supporting it, is not clearly erroneous and should be sustained. Rule 52 (a), Federal Rules of Civil Procedure; *United States* v. *Gypsum Co.,* 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869.

C. *The transfer of trust assets to the guardian in 1946 pursuant to court order does not foreclose imposition of the gift tax under the doctrine of Harris v. Commissioner.*

Although there was no completed gift here in 1943, the Tax Court nevertheless found that the taxpayer (R. 108) "harbored the same donative intent at all times here material", including 1946. Under the terms of the written trust instrument, the death of the original trustee in 1946 required the termination of the trust and the transfer of its corpus to a guardian for the taxpayer's daughter. The concomitance, on

May 23, 1946, of donative intent[6] and unconditional transfer of the property to the guardian gave rise to a completed gift, with consequent gift tax liability in that year. Internal Revenue Code, Sections 1000 and 1002 (Appendix, *infra*).[7] Cf. *Latta* v. *Commissioner,* 212 F. 2d 164 (C.A. 3), and *Camp* v. *Commissioner,* 195 F. 2d 999 (C.A. 1st), involving transfers in trust in which the settlors had retained powers to revoke or revise, dependent upon the agreement of others without adverse interest. It was held that the original transfers did not constitute completed gifts for federal tax purposes, but that gift tax liability was properly evoked in subsequent years upon actual deletion or relinquishment of the powers to amend.

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[6] Even in the absence of a specific finding of donative intent in 1946, the gift tax may be predicated on the unconditional transfer of property to the guardian without receipt of full and adequate consideration of money or money's worth. Cf. *Commissioner* v. *Wemyss,* 324 U. S. 303, 306-307; *Merrill* v. *Fahs,* 324 U. S. 308, rehearing denied, 324 U. S. 888; *Farid-Es-Sultaneh* v. *Commissioner,* 160 F. 2d 812, 816 (C.A. 2d); *Rosenthal* v. *Commissioner,* 205 F. 2d 505, 509-510 (C.A. 2d); *Commissioner* v. *Greene,* 119 F. 2d 383, 386 (C.A. 9th), certiorari denied, 314 U. S. 641.

[7] Note, in this regard, the taxpayer's conditional statement in accord in the schedule attached to her 1946 gift tax return (Ex. 12-L, R. 91):

> The Revenue Agent's office of the Bureau of Internal Revenue, in the course of the examination of donor's income tax return for 1943, has raised a question as to whether said trust was irrevocable. However, if said trust was a revocable gift of said property, * * * the gift of said property became irrevocable upon the death of Richard S. Goldman, the trustee, on March 1, 1946, and the appointment of Clarissa Shortall as guardian of the estate of Lois E. Senderman, a minor, thereafter on May 2, 1946, by the Superior Court of the State of California, in and for the City and County of San Francisco * * * and the transfer of the trust property to said guardian immediately thereafter. * * *

But the taxpayer, relying on *Harris* v. *Commissioner,* 340 U.S. 106, contends that the May 2, 1946, transfer of trust assets to the guardianship estate did not represent a taxable gift because it was made pursuant to court order. The contention is without merit. In the *Harris* case, a settlement of marital property rights between husband and wife, operative by its terms only on entry of a divorce decree, was held exempt from gift taxes. The Court found that the settlement was not based on a voluntary promise or agreement of the parties, but on the command of the divorce court which was required by state law to decree a just and equitable disposition of the parties' property. However, as the Tax Court pointed out (R. 108-109):

> The factual situation present in the *Harris* case is clearly distinguishable at critical and important points, and would appear to have no application here. That case involved a divorce proceeding and a property settlement agreement incident thereto. The settlement in question was clearly an arm's length transaction. The element of donative intent was absent. Nor was a promise or an agreement an operative factor. The transfer was made dependent upon and pursuant to a decree of a court charged under state law with decreeing a just and equitable disposition of the community and separate property of the parties before it. Nevada Compiled Laws, Section 9463.
>
> Although [in the instant case, the taxpayer] * * * failed legally to effectuate a valid gift for tax purposes, since, as we have seen, it was done by a trust revocable under California law, she, nevertheless, harbored the same donative intent

> at all times here material. *Moreover, the role of the state court here* [*with respect to the transfer of trust assets to the guardianship estate*] *was not that of arbiter between two contesting parties. The terms of the trust instrument itself provided for the termination of the trust and the transfer of the corpus thereof to a guardian. As is customary in the cases involving property rights of a minor, application was made to a court of competent jurisdiction for authorization so to transfer the trust assets and for appointment of a guardian to receive and hold the same. The court's function was merely to see that the transfer was in accord with the trust instrument and to appoint a fit guardian. It exercised discretion only with respect to the latter.* (Italics supplied.)

In these circumstances, the state court's imprimatur upon the transfer of May 2, 1946, should not bring this case, *ipso facto,* within the scope of the *Harris* doctrine. The Tax Court correctly observed (R. 109):

> Such broad application [of the doctrine] would have the effect of repealing by judicial process the gift tax statute and would make possible avoidance of a gift tax by the simple expedient of making any gift contingent upon a consent decree of a local court. We cannot believe that the Supreme Court intended or contemplated any such result.

The taxpayer's contention (Br. 39) that the doctrine of the *Harris* case "is applicable in *all* cases where a transfer of property is made pursuant to a state court order" (emphasis supplied) should not be accepted, for it would indeed frustrate "the evident desire of Con-

gress [in imposing the gift tax] to hit all the protean arrangements which the wit of man can devise that are not business transactions within the meaning of ordinary speech * * *." *Commissioner* v. *Wemyss, supra,* p. 306. In this connection, see Taylor and Schwartz, Tax Aspects of Marital Property Agreements, 7 Tax L. Rev. 19, 38-49 (November, 1951), wherein discussion of the gift tax aspects of the broad extension of the doctrine here contended for by the taxpayer is concluded with the admonition (p. 49):

> The consequences to the revenues of such a broad application of the *Harris* case appear to require the strictest limitation of that case to its actual facts.

The authors make it clear (p. 47) that the legislative history of the gift tax does not require or warrant acceptance of the taxpayer's sweeping position in the instant case. Further, they point out (pp. 46-47) that several soundly reasoned pre-*Harris* cases, including a decision of this Court (p. 46) "have refused to permit the interposition of a court decree to prevent the imposition of either gift or of estate tax liability." See *Commissioner* v. *Greene, supra* (payments by the estate of an incompetent to the dependent children of the incompetent held to be subject to a gift tax although paid not only pursuant to a court order, but also in discharge of a legal obligation imposed by state law); *City Bank Co.* v. *McGowan,* 323 U.S. 594 (payments directed by a court to be made to dependents of an incompetent held subject to estate taxes as transfers in contemplation of death to the extent that they exceeded the amount reasonably needed for maintenance

and support); and *Hooker* v. *Commissioner,* 10 T.C. 388, affirmed, 174 F. 2d 863 (C.A. 5th) (transfer for the benefit of a minor child made pursuant to a separation agreement and ratified by a divorce decree held subject to gift tax to the extent that the value of the property transferred exceeded the obligation to support the child during minority).

For post-*Harris* decisions reflecting judicial disinclination to extend the doctrine of that case, see e.g., *Rosenthal* v. *Commissioner, supra,* and *Bank of New York* v. *United States,* 115 F. Supp. 375, 383-384 (S.D. N.Y.). In the *Rosenthal* case, the court concluded that certain arrangements made for the taxpayer's children beyond their support during minority evoked a gift tax. It stated (pp. 508-509):

> The rationale of * * * *Harris* * * * rests basically on the divorce court's power, if not duty, to settle property rights as between the parties, * * *. We do not find this rationale applicable to a decree ordering payments to adult offspring of the parties or to minors beyond their needs for support * * *. * * * Awards to children beyond their needs for support during minority have been held enforceable where based upon a contractual agreement between the parties to the divorce. * * * That is the situation here. But since such a decree provision depends for its validity wholly upon the consent of the party to be charged with the obligation and thus cannot be the product of litigation in the divorce court, we do not consider the rationale of the *Harris* decision applicable to the present case. We therefore conclude that the arrangements here made for the

> taxpayer's daughters beyond their support during minority do not obtain exemption from the federal gift tax by simply receiving the court's imprimatur. The similar result reached in *Hooker* v. *C. I. R.,* 5 Cir., 174 F. 2d 863, and *Converse* v. *C. I. R.,* 5 T.C. 1014, affirmed *C. I. R.* v. *Converse* * * * [163 F. 2d 131 (C.A. 2d)], appears to us a correct interpretation of the law and not in conflict with the more recent decision in the *Harris* case.

In the *Bank of New York* case, it was concluded that the proceeds of certain life insurance policies were properly taxed as part of a decedent's estate. It was contended by the executor that under the doctrine of the *Harris* case, the proceeds were excludible because a separation agreement respecting them had been included in a divorce decree and that, consequently, the wife's claim to the policies was founded upon an obligation imposed by law. The court, however, distinguished the case from *Harris* (pp. 383-384) on the ground that whereas in *Harris* the decree was the operative factor, in the case at bar (as in the instant case) the agreement of the parties created their respective rights and at best the court decree merely afforded an additional sanction. Cf. *Chase National Bank of N. Y.* v. *Commissioner,* decided April 28, 1953 (1953 P-H T.C. Memorandum Decisions, par. 53,148), where, upon facts distinguishable from the instant case (p. 443)), the court held that a compromise agreement in settlement of pending litigation, incorporated in a final court decree, did not effect a taxable gift of the property involved.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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July, 1954.

APPENDIX

INTERNAL REVENUE CODE:

SEC. 1000. IMPOSITION OF TAX.

(a) For the calendar year 1940 and each calendar year thereafter a tax, computed as provided in section 1001, shall be imposed upon the transfer during such calendar year by any individual, resident or non-resident, of property by gift. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 1000.)

SEC. 1002. TRANSFER FOR LESS THAN ADEQUATE AND FULL CONSIDERATION.

Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this chapter, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

(26 U. S. C. 1952 ed., Sec. 1002.)

Deering, Civil Code of California (1937):

§ 2216. *Voluntary trust, what.* A voluntary trust is an obligation arising out of a personal confidence reposed in, and voluntarily accepted by, one for the benefit of another.

§ 2217. *Involuntary trust, what.* An involuntary trust is one which is created by operation of law.

§ 2280. *Revocation of trusts.* Unless expressly

made irrevocable by the instrument creating the trust, every voluntary trust shall be revocable by the trustor by writing filed with the trustee. When a voluntary trust is revoked by the trustor, the trustee shall transfer to the trustor its full title to the trust estate. * * *

Treasury Regulations 108, promulgated under the Internal Revenue Code:

Sec. 86.3 [as amended by T. D. 5833, 1951-1 Cum. Bull. 83] *Cessation of Donor's Dominion and Control.*—

(a) *In general.*— * * *

As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change the disposition thereof, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over the disposition thereof, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

A gift is incomplete in every instance where a donor reserves the power to revest the beneficial title to the property in himself. * * *

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